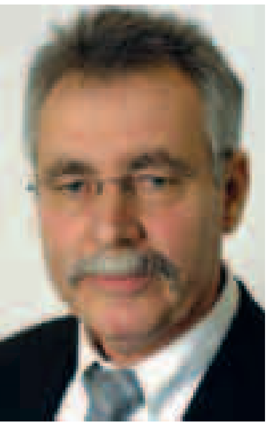

FOR A DUAL INCOME TAX[1]

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German income taxes and business taxes are complicated, in an international comparison they are too high, at least regarding business, and they distort investment and financing decisions and the choice of the form of business organisation. The major purpose of a tax reform is, therefore, tax reduction, especially for internationally mobile capital income as well as the introduction of a decision neutral and thus at the same time simple tax system. Toward this end, the corporation tax must be integrated into income taxation; great importance in this context must be assigned to cross-border investment. Tax reform proposals which fail to include corporation taxes or treat them only in passing, miss the essential problems of taxation.

If a synthetic income tax is to be retained, and there are convincing reasons to do so, a flat tax, i.e. a schedule with a uniform (marginal) tax rate, combined with a comprehensive tax base and relatively high exemptions, would best serve the need for a great tax reform. In order to make Germany an attractive tax for location decisions, the rate of a flat tax should not exceed 30 percent; even better would be a uniform rate of 25 percent. It is likely that the value added tax would have to be raised simultaneously in order to limit revenue losses. I am convinced, however, that the political powers will not be able to force themselves to enact such a courageous tax reform within the next few years. On the other hand, there is the unmistakable need for action; tax competition is getting increasingly fierce.

A pragmatic compromise suggests itself in the form of a dual income tax, patterned on that introduced in Norway, Sweden and Finland in the early 1990s. A dual income tax subjects labour income and comprehensively defined capital income to different tax rates. Labour income would be subject to a progressive income tax, with a top marginal rate of 35 percent. Capital income would include profits of proprietorships and personal ownership firms, dividends, interest, rents as well as private capital gains; it would be subject to a flat tax of 25 percent. Taxing corporate profits at the same rate would fully integrate the corporate income tax in the tax on capital income. The dual income tax is primarily attractive under efficiency points of view. The “Achilles heel” of the dual income tax consists in the delineation of labour income in the form of imputed entrepreneurial salaries and capital income in personal ownership firms.

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